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No. 548

In the Supreme Court of the United States

OCTOBER TERM, 1931

JOSEPH S. MACLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

v.

ALLIANCE INSURANCE COMPANY OF PHILADELPHIA

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE COLLECTOR

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OPINION BELOW

The opinion of the District Court is reported in 49 F. (2d) 361.

JURISDICTION

The certificate of the Circuit Court of Appeals was filed in this Court on December 3, 1931. (Cert., p. 3.) Jurisdiction is conferred upon this Court by Section 239 of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION CERTIFIED

Under the Revenue Act of 1928, is the basis to be used by an insurance company (other than a life or mutual insurance company) in computing "gain during the taxable year from the sale or other disposition of property," acquired before and disposed of after January 1, 1928, its fair market value as of January 1, 1928, the effective date of the Act? (Cert., p. 3.)

STATUTE INVOLVED

(The pertinent provisions of the statute are copied in Appendix A, pp. 28–34, *infra.*)

STATEMENT

The certificate makes the following statement:

The Alliance Insurance Company of Philadelphia, appellee, plaintiff below, is a stock fire and marine insurance company, incorporated under the laws of the Commonwealth of Pennsylvania.

Joseph S. MacLaughlin, appellant, defendant below, is the Collector of Internal Revenue for the First District of Pennsylvania.

The Revenue Act of 1913 and the subsequent acts of 1916, 1917, and 1918 taxed all insurance companies in the same manner as corporations generally. Under these Acts gain which accrued subsequent to March 1, 1913, and was realized during the taxable year from the sale or other disposition of property was taxable as income. Under the Revenue Act of 1921, however, gain by insurance companies (other than mutual) from the sale or other

disposition of property was no longer subject to tax nor were such companies permitted to deduct losses sustained in like manner. The Revenue Acts of 1924 and 1926 reenacted substantially the provisions of the Act of 1921 in this respect. Thus from January 1, 1921, until January 1, 1928, insurance companies (other than mutual) were not subject to income tax upon gain derived from the sale or other disposition of property.

The Revenue Act of 1928, approved May 29, 1928, became effective as of January 1, 1928, as to all except certain specific provisions not here pertinent, which became effective on the date of its approval.

Section 13 of that Act imposes a tax of 12 per cent upon the net income of corporations generally. Supplement G, which is composed of Sections 201 to 208, inclusive, dealing with insurance companies, provides by Section 204 [c. 852, 45 Stat. 791, 844, 845; U. S. C. Sup. V, Title 26, sec. 2204] as follows:

> (*a*) *Imposition of tax.*—In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:
>
> (1) In the case of such a domestic insurance company, 12% of its net income;
>
> * * * * *
>
> (*b*) *Definition of income, etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) GROSS INCOME.—"Gross income" means the sum of (A) * * *, and (B) gain during the taxable year from the sale or other disposition of property;

* * * * *

(c) *Deductions allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

* * * * *

(5) Losses sustained during the taxable year from the sale or other disposition of property;

* * * * *

The foregoing clauses, (b) (1) clause (B) and (c) (5), which provide for the inclusion in the definition of "Gross income" of "gain during the taxable year from the sale or other disposition of property" and that "losses sustained during the taxable year from the sale or other disposition of property" shall be allowed as deductions in computing the net income of such insurance companies, are new.

The Alliance Insurance Company of Philadelphia, appellee, realized gain during the taxable year 1928 from the sale or other disposition of property acquired prior to January 1, 1928, and paid a tax thereon. Joseph S. MacLaughlin, appellant, assessed and collected an additional tax from appellee of $4,153.37 with interest of $199.19, a total of $4,352.56, upon additional gain alleged to have been realized by appellee from the sale or other disposi-

tion of such property during the taxable year 1928. The additional tax so collected was computed by appellant upon the theory that the basis to be used in computing gain resulting from the sale or other disposition of property by insurance companies (other than life or mutual insurance companies) on or after January 1, 1928, as applied to property acquired prior to that date, under the provisions of Section 204 of the Revenue Act of 1928 is the cost, the fair market value as of March 1, 1913, or other basis as provided by Section 113 of the Act and not the fair market value as of January 1, 1928, the effective date of the Act. The additional tax so assessed represents the excess over the amount of the tax that would have been assessed if the gain had been determined on the basis of the value of the property in question as of January 1, 1928, the basis used by appellee, instead of on the basis provided in Section 113 of the Act.

On August 15, 1930, appellee filed with appellant its claim for refund of the additional tax with interest so assessed in the sum of $4,352.56. Appellee's claim for refund of said tax was disallowed by the Commissioner of Internal Revenue on October 10, 1930. Appellee subsequently instituted the present suit against appellant to recover said sum of $4,352.56 with interest thereon from April 19, 1930, the date appellee paid said additional tax to appellant.

Appellant filed an affidavit of defense, raising only questions of law, in accordance with the Penn-

sylvania Practice Act of 1915. The District Court of the United States for the Eastern District of Pennsylvania (Kirkpatrick, J.) held that under the provisions of Section 204 of the Revenue Act of 1928 the basis to be used in computing gain from the sale or other disposition of property owned on January 1, 1928, by insurance companies (other than life or mutual insurance companies) is the fair market value as of January 1, 1928, the effective date of the Act, and not the fair market value as of March 1, 1913, or other basis as provided by Section 113 of the Act. The District Court accordingly held the affidavit of defense insufficient and entered judgment for appellee in the amount claimed with interest. Appellant subsequently perfected his appeal to the Circuit Court of Appeals for the Third Circuit. (Cert., pp. 1–3.)

SUMMARY OF ARGUMENT

This case concerns only sales in 1928 of securities which were purchased prior to that year. We submit that the Commissioner's method of computing the taxable gain on them was correct. He calculated the gain upon the basis prescribed in Section 113 of the Act, i. e., he took as the basis the cost of the property, except in the case of such securities as were acquired prior to March 1, 1913, and which were worth more on that date than their cost, and as to such property he took as a basis the value on March 1, 1913.

The statute contemplates that this basis, provided in Section 113, shall be applicable to gains from sales of property by stock fire insurance companies. Section 111 provides that the basis provided in Section 113 shall apply "except as hereinafter provided in this section." There is no provision in the section excepting such insurance companies from its application. Although Section 204, which imposes the tax on such insurance companies and provides that their gross income shall include "gain during the taxable year from the sale or other disposition of property," does not expressly refer to Sections 111 or 113, it is clear from Section 4 in the introductory provisions, as well as from the structure of the Act as a whole, that general provisions like those of Sections 111 and 113 are to apply to all taxpayers taxed on gains on sales of property unless some other specific provision forbids. There is no provision expressly or inferentially forbidding the application of Sections 111 and 113 to insurance companies taxed under Section 204.

The legislative history of Section 204 shows that Congress intended that in respect of gains, stock fire insurance companies should be treated in the same manner as mutual fire insurance companies, and it is clear that both under the 1928 Act and earlier Acts the basis for computing gains on sales of property by mutual fire insurance companies was that which was here applied by the Commissioner.

The Commissioner's action accords with the construction of the Act which has been consistently adopted by the Treasury Department in formal regulations and other rulings.

There is no room for doubt as to the constitutionality of Sections 111, 113, and 204 of the Act as construed by the Treasury Department. This Court has in several cases considered and overruled the contention that gains on sales of securities accruing since the effective date of the Sixteenth Amendment may not be taxed under that Amendment. But until the provision here involved was attacked, it seems never to have been argued that if any gains on sales are taxable, Congress cannot by an Act passed after the effective date of the Sixteenth Amendment require the inclusion in gross income of all gains which have accrued since that date. Congress has taxed such gains generally, although the Revenue Acts of 1921, 1924, and 1926 did not include such gains in the taxable income of stock fire insurance companies. The exemption from such taxes thus enjoyed for a time did not deprive Congress of the power in 1928 to tax this class of taxpayers on such gains upon the same basis as other corporations. The fact that some of the appreciation in value occurred during the period when no tax was levied on sales resulting in gains is immaterial. Cf. *Cooper* v. *United States*, 280 U. S. 409; *Taft* v. *Bowers*, 278 U. S. 470.

ARGUMENT

I

THE REVENUE ACT OF 1928 PROVIDES THAT THE BASIS FOR COMPUTING GAIN ON THE SALE OF PROPERTY SOLD IN 1928 IS ITS COST OR ITS VALUE ON MARCH 1, 1913, IF IT WAS ACQUIRED PRIOR TO THAT DATE AND WAS ON THAT DATE WORTH MORE THAN ITS COST

The tax on insurance companies (other than life or mutual companies) is imposed by Section 204 of the Act. (See p. 31, *infra.*) Paragraph (b) (1) of this section provides that—

> "Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, * * * and (B) gain during the taxable year from the sale or other disposition of property; * * *

Neither in Section 204 nor any other section relating solely to insurance companies is there any other provision relating to such gain. If the Act specified no basis for computing such gain, the above provision would seem to require the inclusion of all gain realized during the year, i. e., the difference between the proceeds of the sale and the cost of the property, at least to the extent which it could constitutionally be taxed. But the Act does specifically prescribe a basis. Section 111 provides:

> (*a*) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of

property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

There is no provision in Section 111 excepting any insurance company from its operation. Section 113 contains the following provisions:

(*a*) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; [with exceptions not here important].

(*b*) *Property acquired before March 1, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) the cost of such property [with exceptions not here important], or

(2) the fair market value of such property as of March 1, 1913,

whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

It seems clear to us that these provisions of Section 113 are applicable to sales of property by all types of taxpayers who are required to include profits on sales in their gross income.

An examination of the 1928 Act discloses that its structure is peculiar and different from that of any

other tax Act. "Title I—Income Tax" is all that need be considered here, as the other Titles relate to other types of taxes, etc. Title I is divided into three subtitles, designated as follows:

"Subtitle A—Introductory Provisions,"
"Subtitle B—General Provisions,"
"Subtitle C—Supplemental Provisions."

The purpose of Subtitle A is evidently to give a classification or summary of the other headings of the Act and also to show that all of the provisions of Title I (except Supplements E–K) apply to all parts of that Title except in so far as they are modified by more specific provisions applicable to special classes of taxpayers. Section 4 of Subtitle A provides in part as follows:

> The application of the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows:
>
> (*a*) Estates and trusts and the beneficiaries thereof,—Supplement E.
>
> (*b*) Members of partnerships,—Supplement F.
>
> (*c*) Insurance companies,—Supplement G.
>
> (*d*) Nonresident alien individuals,—Supplement H.
>
> (*e*) Foreign corporations,—Supplement I.

The obvious purpose of this new arrangement was that all of the general provisions in Sub-

title B and all of the general provisions of Supplements A-D (including Supplement B in which Section 113 occurs) should apply to the special classes of taxpayers referred to in Supplements E to K unless there is something in the special provisions relating to a class which makes an express exception or is necessarily inconsistent with the general provisions.

This view is confirmed by an examination of the entire Act. The statements of the District Court that Section 204 (which imposes the tax here involved) is "a scheme or code of taxation, complete in itself, * * * without reference to the general provisions of the act," and that "Whenever it was intended to incorporate into section 204 any of the general provisions of the act, such provisions were specifically referred to and included by express language" appear to be erroneous upon such an examination of the Act.

Thus "Supplement G," relating to insurance companies, even in its entirety, consisting of Sections 201–208, inclusive, is not complete in itself. Sections 201–203 relate to the tax on life insurance companies; Section 204 to that on insurance companies other than life or mutual companies; Sections 205–207 contain provisions applying to the taxes imposed both by Sections 201 and 204; and Section 208 applies to mutual insurance companies other than life companies. All of the provisions of "Supplement G" together (i. e., Sections 201–208) occupy less than five pages of

the Statutes at Large (45 Stat. 842–846). This is in marked contrast with the provisions applicable to corporations generally, including as they do Sections 13 to 149 (with a few exceptions), and occupying about forty pages of the Statutes at Large (45 Stat. 797–837). Congress must have intended that many of these provisions in Sections 13 to 149 should be applicable to insurance companies for otherwise the statute in its application to insurance companies would be quite incomplete.

Thus, for example, there is no express reference in Section 204 or in any other part of Supplement G to the following sections, which are the only sections in the Act covering the matters to which they relate: Section 52, requiring corporations to file returns; Section 56, specifying the time for payment of tax; Section 104, forbidding accumulation of surplus to avoid surtaxes; Section 105, providing for the taxable period embracing years with different laws; Section 118, disallowing losses on sales of securities if within thirty days of the sale the taxpayer buys substantially identical property; Sections 141 and 142, relating to consolidated returns; Section 146, penalizing taxpayers for willful failure to pay the tax, to make returns and the like. Other essential provisions which are not included in Section 204 by reference or otherwise are found in Sections 271–277, providing for assessment and collection of deficiencies, including provisions relating to the Board of Tax Appeals and statute of limitations; Sections 291–299, relating to interest

and additions to the tax; Section 311, relating to transferred assets; and Section 322, relating to refunds and credits. Such provisions by virtue of their generality and the provisions of Section 4 of Subtitle A are, we submit, applicable to insurance companies.

Section 141(e) shows the intention of Congress that the general provisions should apply to insurance companies unless specific provision to the contrary was made.

Moreover, it is noteworthy that Section 207 in Supplement G, expressly provides that gross income "shall *not* be determined in the manner provided in Section 119." This plainly indicates that the general provisions of Section 119 would apply to insurance companies in the absence of express exception. It is true that Sections 204, 205, and 206 do incorporate by reference provisions of certain general sections. Thus, Section 204, in listing ten deductions allowed in computing the net income of an insurance company subject to the tax imposed by this Section, includes six items in which some part of Section 22 or Section 23 is incorporated by reference, such as "Taxes as provided in Section 23(c)." The list of deductions was intended to be exclusive and it was therefore necessary in this case to incorporate the deductions authorized under Sections 22 and 23 if they were to be allowed.

Deductions allowed insurance companies differ in many respects from those allowed other cor-

porations. The method adopted was a short and convenient one for indicating just what deductions insurance companies are to have. No such situation is presented in regard to that provision of Section 204(b), which states that gross income shall include "gain during the taxable year from the sale or other disposition of property," since Section 204 contains no other provisions in regard to such gain. The general provisions in regard to determination of gains, Sections 111–113, cover many questions which must arise in connection with sales of property by insurance companies. There is no provision in Section 204 or elsewhere in Supplement G specifying the basis on which losses on sales of property are to be computed.

Although, as we have stated, there are in the sections relating to insurance companies a few references to the general provisions of the Act, the usual treatment seems to have been not to make reference to other provisions of the Act, but rather to rely upon the introductory provisions of Section 4 (p. 11, *supra*) as sufficient to impose such provisions upon insurance companies, except in so far as there are express exceptions or obviously inconsistent provisions. This scheme of the statute is applied to other special classes of taxpayers, such as estates (provided for in Supplement E) and nonresident alien individuals (provided for in Supplement H). Many of the general provisions of the Act not contained in Supplements E and H obviously were intended to apply to the taxpayers covered by these

supplements. Congress apparently intended that they should be applicable and inserted no provisions either in Supplement E or Supplement H making them applicable because Section 4 of Subtitle A was intended to have this effect.

Nor do we agree with the meaning attributed by the District Court to the following introductory language of Section 204(a):

> In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:
>
> (1) In the case of such a domestic insurance company, 12 per centum of its net income.

It was necessary, or at least desirable, to state that the tax imposed by this section was "in lieu of the tax imposed by section 13" so as to make it perfectly clear that an insurance company is not subject to both taxes, inasmuch as Section 13 imposes a tax "upon the net income of every corporation" and Section 701 defines the term "corporation" to include insurance companies. Although the tax imposed by Section 204 was at the same rate as the tax on ordinary corporations, the net income upon which it was based was computed in a different manner.

The taxpayer has argued that if Congress had intended to apply to insurance companies the basis of determining gain provided in Section 113, it

would have referred specifically to this section, but, as we have pointed out, the usual method was not to refer to specific sections. There is more reason to say that if Congress had intended by Section 204 to prescribe a basis for determining gains different from that carefully detailed in this Act and different from any basis ever employed in any Act, it would have definitely specified the novel basis. Moreover, it is worthy of notice that the provision placing capital gain in the gross income of insurance companies was inserted in Section 204 by amendment to the bill on the floor of the Senate after it had passed the House. (See pp. 43–44, *infra.*) It is to be presumed that an amendment thus proposed was not intended to result in a novel basis for computing capital gain to which no reference is made in the amendment.

Indeed, if any doubt exists as to the intention of Congress that Section 113 should apply to gains taxed under Section 204, that doubt is resolved in favor of our view by the legislative history of the Act. A report of the Joint Committee on Internal Revenue Taxation (made up of members of both Houses) made certain recommendations which were adopted, as is shown by the Report of the Ways and Means Committee which accompanied the Revenue Act of 1924. (Pertinent extracts from these reports appear on pp. 39–41, *infra.*) The report of the Joint Committee stated:

> A recommendation was approved that the act be rearranged so as to collect at one place (preferably the beginning of the act) the general provisions which apply to the cases of practically all taxpayers, and to carry to appropriate places at subsequent parts of the act the special provisions which apply only to the occasional transaction or to particular classes of tax cases.

This recommendation was adopted. Although the provision regarding taxation of gains on sales of property did not appear in the bill as then presented, the statement quoted above does support our contention as to the meaning of the introductory clauses in Section 4 of the bill, which, if correct, destroys most of the argument of the taxpayer.

After the bill had passed the House, and while it was being considered in the Senate, Senator Reed of Pennsylvania proposed as an amendment the insertion in Section 204 (b) (1) of the words "(B) gain during the taxable year from the sale or other disposition of property." In explanation, he said that, in respect of this item, the amendment would put stock insurance companies "on the same basis" as mutual companies. (For a full report of his statements, see pp. 44–46, *infra.*) It is perfectly clear that mutual insurance companies under the 1928 Act, as well as under previous Acts, were required to compute gains on sales of prop-

erty upon the basis of cost or value on March 1, 1913, if that was greater.[1]

In this situation the language of this Court in *Knowlton* v. *Moore*, 178 U. S. 41, is particularly apposite. It was there said (p. 77):

> We are, therefore, bound to give heed to the rule, that where a particular construction of a statute will occasion great inconvenience or produce inequality and injustice, that view is to be avoided if another and more reasonable interpretation is present in the statute.

---

[1] The following provisions of various Acts lead to this conclusion: Section 2 (2) of the Revenue Act of 1921 (c. 136, 42 Stat. 227) defines corporations as including insurance companies. Sections 2 (2) of the 1924 (c. 234, 43 Stat. 253) and the 1926 Acts (c. 27, 44 Stat. 9) contain the same definition. Section 246 of the 1921, 1924, and 1926 Acts provide for taxation of all insurance companies other than life or mutual. Sections 242 to 245 of the same Acts provide for the taxation of life insurance companies. There are no provisions in any of these Acts specifically referring to mutual companies, and consequently they are taxed in the same manner as other corporations. Section 202 of the 1921 Act and Sections 202, 203, and 204 of the 1924 and 1926 Acts specify the manner of determining gains. Section 208 of the 1928 Act (c. 852, 45 Stat. 791) states that mutual insurance companies shall be taxable in the same manner as other corporations with certain exceptions, none of which deal with gains or losses. Sections 113 (a) of the 1928 Act, 204 (a) of the 1924 and 1926 Acts, and 202 (a) of the 1921 Act all provide that the basis for determining the gain from the sale of property acquired after Feb. 28, 1913, shall be the cost of such property. Subsection (b) of the same sections provide that in case of property acquired before March 1, 1913, the basis shall be its cost or fair market value as of March 1, 1913, whichever is greater.

The construction for which we contend is that adopted and consistently followed by the Treasury Department. See Regulations 74, promulgated under the Act of 1928, Articles 991 and 992; and I. T. 2444, C. B. VII–2, p. 63. (Pp. 35–38, *infra*.)

The question involved in the instant case has been passed upon by no court except the District Court in the instant case.

II

THERE IS NO ROOM FOR DOUBT AS TO THE CONSTITUTIONALITY OF SECTIONS 111, 113, AND 204 OF THE ACT AS CONSTRUED BY THE TREASURY DEPARTMENT

The argument of the taxpayer that these provisions, so construed, are unconstitutional rests on the assumption that a tax upon the entire gain, including that part of the profit which represented an increase in value prior to 1928 is, in part at least, a tax upon capital. This case concerns only sales which were made after the effective date of the Act of 1928, i. e., January 1, 1928. Although that Act was not approved until May 29, 1928, the taxpayer has conceded that Congress could fix as the basis for determining gain the fair market value as of December 31, 1927.[2]

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[2] This concession is, of course, required by decisions of this Court in somewhat analogous cases supporting retroactive tax legislation. *Cooper* v. *United States*, 280 U. S. 409. Cf. *Milliken* v. *United States*, 283 U. S. 15; *Brushaber* v. *Union Pac. R. R.*, 240 U. S. 1, 20. (For a list of taxing statutes which were retroactive in effect, see footnote 1 in the dissenting opinion in *Untermyer* v. *Anderson*, 276 U. S. 440, 447.)

We fail to see any ground for distinction between the period from March 1, 1913, to January 1, 1928, and the period from January 1, 1928, to May 29, 1928. If, as to sales made in 1928, Congress could include the gains accruing during the latter period, what prevented it from including the gains accruing during the earlier period? There was no change in the Constitution during that time.

If an income tax Act may be made effective on a date more than a year before its passage (as was the case in the Revenue Act of 1918, approved on February 24, 1919, 40 Stat. 1057 [3]), it is obvious that no constitutional right can depend upon the effective date of such an Act, at least if that date does not antedate March 1, 1913, the effective date of the Sixteenth Amendment.

The decisions of this Court, we submit, make it clear that there is no room here for any constitutional objection. It is, of course, well settled that gains on the sales of securities may be subjected to income tax, under the Sixteenth Amendment. *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509; *Eldorado Coal Co.* v. *Mager*, 255 U. S. 522; *Goodrich* v. *Edwards*, 255 U. S. 527; *Walsh* v. *Brewster*, 255 U. S. 536. See also *Willcuts* v. *Bunn*, 282 U. S. 216; *Cooper* v. *United States*, 280 U. S. 409; *Lucas* v. *Alexander*, 279 U. S. 573; *Taft* v. *Bowers*, 278 U. S. 470. Although attacks have been made upon

[3] See *Fawcus Machine Co.* v. *United States*, 282 U. S. 375, 379.

the constitutionality of the tax on gains on sales of securities on many grounds, and it is obvious that in many of the cases cited the gain taxed included accretions in value prior to the effective date of the applicable Act,[4] apparently it has never occurred to anyone except those now attacking the 1928 Act, that the contention here made was worth making. We have been able to find no discussion of the point by this Court or any other court (except in the instant case), although the practice under every tax Act, beginning with the Revenue Act of 1916, has been to include in gains all increase in value since

[4] This definitely appears of record in *Merchants' L. & T. Co.* v. *Smietanka*, *supra*, 255 U. S. 509. The declaration filed in the District Court alleged that the value of certain stock which was sold in February, 1917, for $1,280,996.64 was worth $561,798 on March 1, 1913, and $714,150 on January 1, 1916, and $1,263,567.50 on January 1, 1917. The declaration also averred that the tax paid included the entire gain over the March 1, 1913, value, and "that said appreciation in money value of said capital assets did not wholly or in part or proportion thereof constitute income, and was not subject to tax as income within the meaning of the Sixteenth Amendment." (No. 608, Oct. Term 1920, R. 6-7, 10.) The District Court sustained a general demurrer to the declaration, and its judgment was affirmed by this Court. The brief filed here in behalf of the taxpayer indicates that the only constitutional point which was made was that no gain whatever on the sale of the property involved could be taxed. But the taxpayer did contend that the Act in question should not be construed "to tax as income for the year of conversion the total increase in the value of capital assets accruing over an extended series of years." (Br. pp. 77 *et seq.*)

March 1, 1913, rather than to draw the line at the effective date of the Act.[5]

In many of these cases it seems to have been assumed, at least by this Court, that Congress could tax all of such gain without deduction of that part of it which was attributable to accretions prior to

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[5] Section 10 of the Revenue Act of 1916 (c. 463, 39 Stat. 756, 765), dealing with income tax on corporations, provides that—

"For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation * * * of property * * * acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained."

The Revenue Act of 1917 (c. 63, 40 Stat. 300) is an amendment of the 1916 Act, and the method of determining taxable income under the prior Act is continued in use except in so far as amended.

In the Revenue Act of 1918 (c. 18, 40 Stat. 1057) the basis for determining gain or loss sustained from the sale or other disposition of property is set forth in Section 202 (a), and is, in the case of property acquired before March 1, 1913, the market value of the property on that date, and in the case of property acquired after that date it is to be the cost or the inventory value, if the inventory is made in accordance with Section 203.

The basis for determining gain in the Revenue Acts of 1921 (Sec. 202, c. 136, 42 Stat. 227, 229), 1924 (Sec. 204, c. 234, 43 Stat. 253, 258), 1926 (Sec. 204, c. 27, 44 Stat. 9, 14), and 1928 (Sec. 113, c. 852, 45 Stat. 791, 818) is the cost, where the property was acquired after March 1, 1913, or, if the property was acquired before that time, it is cost or market value as of March 1, 1913, whichever is greater.

the effective date of the applicable act. See, for example, *Goodrich* v. *Edwards, supra,* 255 U. S. 527, 533–534; *Taft* v. *Bowers, supra,* 278 U. S. 470, 479. And in *Eisner* v. *Macomber,* 252 U. S. 189, 212, the Court in passing upon the constitutionality of the tax on stock dividends in the Act of 1916 said:

> It is said that a stockholder may sell the new shares acquired in the stock dividend; and so he may, if he can find a buyer. It is equally true that if he does sell, and in doing so realizes a profit, such profit, like any other, is income, and *so far as it may have arisen since the Sixteenth Amendment* is taxable by Congress without apportionment. The same would be true were he to sell some of his original shares at a profit. (Italics ours.)

(We are not considering accretions attributable to the period before March 1, 1913, the effective date of the Sixteenth Amendment, because the Commissioner has not asserted the right to make the basis less than the value on that date. Cf. *Lucas* v. *Alexander, supra,* 279 U. S. 573, 577.)

This Court has held that a donee has no ground for objecting to the payment of a tax on a gain which includes accretions on securities attributable to a period before the securities were given to him (*Taft* v. *Bowers, supra*), or to the payment of a tax on a sale made before the passage, but after the effective date, of the taxing Act (*Cooper* v. *United States, supra*). The taxpayer here has less reason

to complain that the tax imposed deprived it of property without due process of law than had the taxpayers in those cases.

The cases cited by the District Court as supporting the taxpayer's view, *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179, and *Hays* v. *Gauley Mt. Coal Co.*, 247 U. S. 189, seem to us not to bear upon the point. They involve merely the construction of the Corporation Excise Tax Act of 1909.

Other cases which are relied upon by counsel for the taxpayer, such as *Lynch* v. *Turrish*, 247 U. S. 221, and *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, arose under the Tariff Act of 1913, the first income tax Act. They hold merely that under that Act gains accruing prior to March 1, 1913, the effective date both of the Act and the Amendment, were not taxable.

None of these cases holds that Congress can not, by an Act passed after the effective date of the Sixteenth Amendment, require the inclusion in gross income of all gains which have accrued since that date.

Certain
~~The~~ statements in the certificate of the Circuit Court of Appeals and the opinion of the District Court indicate that these courts felt that possibly the constitutionality of the provisions of the 1928 Act are affected by the fact that during the period from 1921 through 1927 gains on sales of property

made by stock fire insurance companies were not taxed, although such gains of practically all other corporations were.*

We submit that it is clear that the exemption thus extended for a time is unimportant. The company was chargeable with knowledge that Congress had the power to impose such a tax at any time, and its mere failure to do so during the years 1921 through 1927 invested the company with no additional constitutional rights as to sales in future years. Obviously the failure of Congress to include in gross income the gains from sales made during certain years did not affect the nature of

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* The provisions applicable to stock fire insurance companies which operated to exclude gains on sales from gross income are those of Section 246 (b) (I) in each of the following Revenue Acts: 1921 (c. 136, 42 Stat. 227); 1924 (c. 234, 43 Stat. 253); and 1926 (c. 26, 44 Stat. 9).

This was a departure from the scheme of previous Acts, for the Revenue Acts of 1913, 1916, 1917, and 1918 taxed such companies in the same manner as other corporations. See Section II G (a), Tariff Act of 1913 (c. 16, 38 Stat. 114, 172); Section 10, Revenue Act of 1916 (c. 463, 39 Stat. 756, 765); Sections 200 and 201, Revenue Act of 1917 (c. 63, 40 Stat. 300, 302); Sections 1 and 230 (a), Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1075). Thus the provisions of those Acts requiring the inclusion in gross income of gains derived from the sale or other disposition of property were applicable to insurance companies. See Section II B, Tariff Act of 1913; Section 2 (a), Revenue Act of 1916; Section 1200, Revenue Act of 1917; Section 213 (a), Revenue Act of 1918.

The provisions in the later Acts operating to tax corporations generally on gains of sales of securities are Sections 213 and 233 of each of the following Revenue Acts: 1921, 1924, and 1926.

gains from sales made in later years. Nor could such a suspension of action by Congress limit its power in later years. The Act of 1928 does not purport to tax any sales made prior to 1928 or to apply to the sales of stock fire insurance companies any different rules than those which are applied to similar sales of other corporations.

No question of retroactivity is involved, and we know of no case holding that there must be continuity of taxation in order that Congress may preserve the power to tax. The decision in *Merchants L. & T. Co.* v. *Smietanka, supra,* 255 U. S. 509, indicates the contrary, although the point seems not to have been raised.

CONCLUSION

The question certified in this case should be answered in the negative. The basis to be used in this case is that provided in Section 113 of the Revenue Act of 1928.

Respectfully submitted.

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FEBRUARY, 1932.

APPENDIX A

STATUTES

The pertinent provisions and headings of the Revenue Act of 1928 (c. 852, 45 Stat. 791, 795, 797, 811, 815, 816, 818, 842, 844, 845) are as follows:

TITLE I—INCOME TAX

SUBTITLE A—INTRODUCTORY PROVISIONS

SEC. 1. APPLICATION OF TITLE.

The provisions of this title shall apply only to the taxable year 1928 and succeeding taxable years. Income, war-profits, and excess-profits taxes for taxable years preceding the taxable year 1928 shall not be affected by the provisions of this title, but shall remain subject to the applicable provisions of prior revenue Acts, except as such provisions are modified by Titles III, IV, and V of this Act or by legislation enacted subsequent to this Act. (U. S. C., Sup. V, Title 26, Sec. 2001.)

SEC. 3. CLASSIFICATION OF PROVISIONS.

The provisions of this title are herein classified and designated as—

Subtitle A—Introductory provisions,

Subtitle B—General provisions, divided into Parts and sections,

Subtitle C—Supplemental provisions, divided into Supplements and sections. (U. S. C., Sup. V, Title 26, Sec. 2003.)

SEC. 4. SPECIAL CLASSES OF TAXPAYERS.

The application to the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows:

(a) Estates and trusts and the beneficiaries thereof,—Supplement E.

(b) Members of partnerships,—Supplement F.

(c) Insurance companies, — Supplement G.

(d) Nonresident alien individuals,—Supplement H.

(e) Foreign corporations,—Supplement I.

(f) Individual citizens of any possession of the United States who are not otherwise citizens of the United States and who are not residents of the United States,—Supplement J.

(g) Individual citizens of the United States or domestic corporations, satisfying the conditions of section 251 by reason of deriving a large portion of their gross income from sources within a possession of the United States,—Supplement J.

(h) China Trade Act corporations,—Supplement K. (U. S. C., Sup. V, Title 26, Sec. 2004.)

SUBTITLE B—GENERAL PROVISIONS

* * * * *

Part II—Computation of Net Income

SUBTITLE C—SUPPLEMENTAL PROVISIONS

Supplement B—Computation of Net Income

[Supplementary to Subtitle B, Part II]

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(*a*) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(*d*) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this *title* shall be determined under the provisions of section 112. (Italics supplied.) (U. S. C., Sup. V, Title 26, Sec. 2111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(*a*) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized * * *. (U. S. C., Sup. V, Title 26, Sec. 2112.)

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(*a*) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of

property acquired after February 28, 1913, shall be the cost of such property; * * * [With exceptions not here material.]

(*b*) *Property acquired before March 1, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) the cost of such property (or, in the case of such property as is described in subsection (a) (1), (4), (5), or (12) of this section, the basis as therein provided), or

(2) the fair market value of such property as of March 1, 1913,

whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date. (U. S. C., Sup. V, Title 26, Sec. 2113.)

Supplement G—Insurance Companies

* * * * *

SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

(*a*) *Imposition of tax.*—In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company, 12 per centum of its net income;

(2) In the case of such a foreign insurance company, 12 per centum of its net income from sources within the United States.

(*b*) *Definition of income, etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) GROSS INCOME.—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property;

(2) NET INCOME.—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section.

(3) INVESTMENT INCOME.—"Investment income" means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) UNDERWRITING INCOME.—"Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) PREMIUMS EARNED.—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on out-

standing business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) LOSSES INCURRED.—"Losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) EXPENSES INCURRED.—"Expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by subsection (c) of this section.

(c) *Deductions allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 23(a);

(2) All interest as provided in section 23(b);

(3) Taxes as provided in section 23(c);

(4) Losses incurred as defined in subsection (b) (6) of this section;

(5) Losses sustained during the taxable year from the sale or other disposition of property;

(6) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(7) The amount received as dividends from corporations as provided in section 23(p);

(8) The amount of interest earned during the taxable year which under section 22(b)(4) is exempt from taxation under this title, and the amount of interest allowed as a credit under section 26;

(9) A reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23(k);

(10) In the case of such a domestic insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $3,000; but if the net income is more than $25,000 the tax imposed by this section shall not exceed the tax which would be payable if the $3,000 credit were allowed, plus the amount of the net income in excess of $25,000.

(*d*) *Deductions of foreign corporations.*—In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in Supplement I.

(*e*) *Double deductions.*—Nothing in this section shall be construed to permit the same item to be twice deducted.

APPENDIX B

REGULATIONS AND RULINGS OF THE TREASURY DEPARTMENT

Regulation 74, promulgated under the Revenue Act of 1928 by the Acting Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, contained the following (pp. 269–270):

> ART. 991. *Tax on insurance companies other than life or mutual.*—For the calendar year 1928 and subsequent years all insurance companies (other than life or mutual companies) are subject to the tax imposed by section 204. Mutual insurance companies (other than life) remain subject to the tax imposed by section 13. The term "insurance companies" as used in this article and in articles 992 and 993 means only those companies subject to the tax imposed by section 204. The rate of the tax imposed by section 204 is 12 per cent, and the net income upon which the tax is imposed, as defined in section 204, differs from the net income of other corporations. Insurance companies are entitled to the benefit of section 117 (net losses) but not of section 101 (capital gains and losses). All provisions of the Act and of these regulations not inconsistent with the specific provisions of section 204 are applicable to the assessment and collection of this tax, and insurance companies are subject to the same penalties as provided in the case of returns and payment of income tax by other corporations. Since section 204 pro-

vides that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and since the annual statement is rendered on the calendar year basis, the first returns under section 204 will be for the taxable year ending December 31, 1928.

ART. 992. *Gross income of insurance companies other than life or mutual.*—Gross income as defined in section 204 (b) means the gross amount of income earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, as well as the gain derived from sale or other disposition of property. It does not include increase in liabilities during the year on account of reinsurance treaties, remittances from the home office of a foreign insurance company to the United States branch, borrowed money, gross increase due to adjustments in book value of capital assets, and premium on capital stock sold. The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Act will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the Act. By reason of the definition of investment income, miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as dividends declared, home office remittances and receipts, and special deposits, are ignored. Gain or loss from agency balances and bills receiv-

able not admitted as assets on the underwriting and investment exhibit will be ignored, excepting only such agency balances and bills receivable as have been charged off the books of the company as bad debts, or, having been previously charged off, are recovered during the taxable year.

The following is a ruling of the Income Tax Unit of the Bureau of Internal Revenue (I. T. 2444; C. B. VII–2, p. 63):

> The question is presented relative to the basis to be used in computing gain or loss resulting from the sale or other disposition of property by insurance companies (other than life or mutual insurance companies) under section 204 of the Revenue Act of 1928.
>
> In defining the term "gross income," clause (A) of section 204 (b)1 of the Revenue Act of 1928, relative to investment income and underwriting income, is substantially the same as section 246 (b)1 of the Revenue Act of 1926. Section 204 (b)1 of the Revenue Act of 1928, however, contains a new provision, clause (B), which provides that gross income also includes "gain during the taxable year from the sale or other disposition of the property." Section 204 (c)5 is also new and provides that "Losses sustained during the taxable year from the sale or other disposition of property" shall be allowed as deductions in computing the net income of such insurance companies. Inasmuch as these provisions in the Revenue Act of 1928 are new, the question is presented as to whether, in the case of property owned by such taxpayers on January 1, 1928, the basis to be used in computing gain or loss is the fair market value of the property on

that date or whether the basis is that provided by section 113 of the Act.

Section 111 (a) of the Revenue Act of 1928, relating to the computation of gain or loss from the sale or other disposition of property, provides as follows:

"Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized."

Inasmuch as this is a general provision for the determination of gain or loss, it is applicable to all sales or other dispositions of property as a result of which a taxable gain or deductible loss is recognized for income tax purposes. Such being the case, it is applicable to the sale or other disposition of property by insurance companies under section 204. The basis to be used in computing gain or loss resulting from the sale or other disposition of property by such insurance companies on or after January 1, 1928, under the provisions of section 204 of the Act is, therefore, the cost, the fair market value as of March 1, 1913, or other basis as provided by section 113 of the Act, and not the fair market value as of January 1, 1928, the effective date of the Income Tax Act of 1928.

APPENDIX C

Legislative History of the Provisions of Section 204 (b) (1) (B) of the Revenue Act of 1928

In the report of the Joint Committee on Internal Revenue Taxation, dated December 22, 1927 (Document No. 139, 70th Congress, 1st Session), the chairman of the Committee in discussing simplification of revenue legislation, stated (page 2):

> * * * A recommendation was approved that the act be rearranged so as to collect at one place (preferably near the beginning of the act) the general provisions which apply to the cases of practically all taxpayers, and to carry to appropriate places at subsequent parts of the act the special provisions which apply only to the occasional transaction or to particular classes of tax cases. The result of such a rearrangement is that the ordinary taxpayer is likely to find in the first few pages of the act all of the statute law of interest to him. There were also recommendations for the use of headings to sections and subsections, for improved forms of cross-reference and for the use of certain typographical improvements which make the finding of a particular provision less difficult than under prior laws. Finally, it was recommended that the 1926 Act be retained in force so far as it relates to the estate tax and the miscellaneous taxes, thus avoiding the repetition of those provisions in the new act. A similar recommendation was made with respect to the administrative provi-

sions which relate solely to taxes imposed by the Act of 1926 and prior laws. The result is to make the new act an income tax act which is practically free of the complicated provisions relating to prior years, most of the tax cases of which are closed out at the present time. * * *

Under the heading "Uncompleted Work—Investigation," there is the following:

(*c*) *Insurance.*—There are many special provisions in the Revenue Act relating to insurance companies. It appears that but little attention has been given to these provisions since the Revenue Act of 1921 was enacted. One of the specific points being investigated on this subject is the effect of exempting such companies from all tax on capital gains.

* * * * *

(*f*) *Gain or loss.*—The provisions relating to the recommendation of gain or loss from sales or exchanges have presented difficult questions. A report on this subject that will show the operation and effect of the present statute has been undertaken.

In the Appendix of that report there is a summary of recommendations of the Joint Committee. Under the heading of "Simplification" is the following statement (p. 7):

The arrangement of sections in the act is not satisfactory. A taxpayer can not find at any one place, a simple statement of the basic principles of the income tax. A complete rearrangement, published in Volume II of this report, is recommended, a principal feature of which is that all provisions of general interest to the great body of taxpayers

are collected in sixteen pages at the beginning of the act.

In its present form the act embraces several complicated provisions relating solely to taxes under earlier laws. The Bureau of Internal Revenue is almost current with its work and these provisions no longer have the importance they once had. They should be omitted from future revenue acts. Accordingly, it is recommended that the Revenue Act of 1926 be continued in force for the adjustment of old cases and that the sections above referred to be entirely omitted from the next Revenue Act. * * *

The introductory paragraph of the Report of the Committee on Ways and Means of the House of Representatives, dated December 7, 1927 (House Report No. 2, 70th Congress, 1st Session), was as follows:

> The Committee on Ways and Means, to which was referred the bill (H. R. 1) to reduce and equalize taxation, provide revenue, and for other purposes, having had the same under consideration, reports it back to the House without amendment and recommends that the bill do pass.

The following statements were also in this Report (p. 2):

> The present law contained a provision for the creation of a Joint Committee of the House and Senate on Internal Revenue Taxation. One of the duties of this Committee was to consider measures for the simplification of the Revenue Act. * * * Not all the recommendations of the Joint Committee were approved—in fact, your Committee did not have time to properly consider

all of them. But the greater part of the recommendations of the Joint Committee were adopted and are part of the bill, among which is the rearrangement of the law.

On page 11 of this Report under the heading of "Structure of New Bill as Compared With Prior Revenue Acts," it was said:

> The bill in one respect differs materially from the Revenue Acts of 1918, 1921, 1924, and 1926. Each of those Acts reenacted all the provisions of the preceding Act, with such changes and omissions as the policy of Congress dictated, and then repealed the preceding Act, with certain exceptions.

On page 12 of the same Report, under the heading of "Rearrangement of Income Tax Title," is the following statement:

> The bill embodies a proposed new arrangement for the income tax title. The basis for the arrangement is the distribution of the provisions by two classifications: General Provisions and Supplemental Provisions. There are a few Introductory Provisions.
>
> The General Provisions are those which apply to the ordinary transactions of the ordinary classes of taxpayers. It is believed that approximately 80 per centum of the taxpayers who file returns under the new Act will find in the General Provisions practically all the income tax statute law of interest to them. The General Provisions are divided into Parts.
>
> The Supplemental Provisions comprise all provisions of the income tax title other than the General Provisions and the Introductory Provisions. In the main, the Supplemental Provisions are those which apply only to extraordinary classes of taxpayers or which

apply only to the extraordinary transactions of ordinary classes of taxpayers. The Supplemental Provisions are divided into Supplements.

The Committee on Finance of the Senate, to which was referred from the House bill (H. R. 1), which subsequently became the Revenue Act of 1928, reported the bill favorably to the Senate with certain amendments. (Senate Report No. 960, May 1, 1928, 70th Congress, 1st Session.) On page 17 of this Report, under the heading, "Structure of New Bill as Compared with Prior Revenue Acts," the discussion of the changed form of the bill is substantially the same as that under the same heading of the House Report on page 11. Likewise the discussion on page 18 of the Senate Report, under the heading "Rearrangement of Income Tax Title," is the same as that under the same heading in the House Report on page 12.

The Revenue Bill of 1928 (H. R. 1, 70th Congress, 1st Session) as passed by the House and as introduced in the Senate did not tax the gain derived from the sale or other disposition of property in the case of insurance companies generally.

It was while the Bill was before the Senate for consideration that Senator Reed of Pennsylvania, during the debate and from the floor, introduced Senate Amendments 115, 116, 117, and 118, proposing to tax the gains derived during the taxable year by insurance companies (other than life or mutual insurance companies) from the sale or other disposition of property, with corresponding deductions for losses sustained during the taxable year in the sale or other disposition of such property.

Section 204 (b) as passed by the House, with the Amendments of Senator Reed added in italics, reads as follows:

(b) *Definition of Income, etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) *Gross Income.*—"Gross Income" means [115] *the sum of* (*A*) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, [116] *and* (B) *gain during the taxable year from the sale or other disposition of property;*

(2) *Net Income.*—"Net Income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section.

* * * * * *

(c) *Deductions allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

* * * * * *

(4) Losses incurred [117] *as defined in subsection* (b) (6) *of this section;*

[118] (5) *Losses sustained during the taxable year from the sale or other disposition of property.*

When Senator Reed introduced these Amendments on May 21, 1928, the following colloquy occurred (Cong. Record, Vol. 69, Part 9, page 9337):

Mr. REED of Pennsylvania. Mr. President, I offer the amendment which I send to the desk.

The VICE PRESIDENT. The amendment will be stated.

The CHIEF CLERK. On page 146, at the end of line 10, insert "the sum of (A)", and in line 16, after "Commissioners," insert a comma and the following: "and (B) gain during the taxable year from the sale or other disposition of property."

On page 149, line 1, after "incurred," insert "as defined in subsection (b) (6) of this section" and after line 1, insert a new paragraph to read as follows:

"(5) Losses sustained during the taxable year from the sale or other disposition of property.",

On page 149, renumber paragraph (6) to (9), inclusive.

Mr. REED of Pennsylvania. Mr. President, there are three amendments that go together. They are all part of the same idea. In brief, they are this:

At the present time, a mutual fire-insurance company or a mutual casualty company or a mutual marine-insurance company—not life insurance; this has nothing to do with life insurance—any mutual company has to pay a tax on the profits that it makes in dealing in stocks or bonds or real estate; but, as the law now stands, a fire-insurance company which has capital stock, and is owned by stockholders instead of policyholders, can deal in stocks and make a profit on the purchase and sale of them and pay no tax whatsoever on that profit. The same thing is true of a stock casualty company or a stock marine-insurance company.

I can imagine reasons why Congress would want to be more lenient to mutuals than to stock companies. I can not imagine,

nor has anyone suggested, any reason why we should be more lenient with companies that are owned by stockholders than with companies that are owned by policyholders.

Mr. NORRIS. Mr. President, may I make an inquiry of the Senator?

Mr. REED of Pennsylvania. Certainly.

Mr. NORRIS. Is it right, then, to say that under existing law, without the Senator's amendment, we are more lenient to stock companies than to mutual companies?

Mr. REED of Pennsylvania. Absolutely.

Mr. NORRIS. If the amendment is agreed to we put them on the same basis?

Mr. REED of Pennsylvania. We put them on the same basis.

I am not going to speak long about this matter, but let us have no doubt about it. As I said in the Committee of the Whole, if any rich man in America wants to avoid taxes to-day, the finest way that I know of to do it is to buy control of a little stock fire-insurance company and use that as his holding company, because he may gamble in bonds or stocks or lands as he pleases, and he does so absolutely tax free. Outside of the life-insurance companies—and the Senate settled that, so I am not going to discuss them—there is no other business corporation in America that can enjoy such profits without paying any tax upon them. I can see no defense for it. I think the only explanation for it is that it was an accident of legislation that Congress never fully understood.

The VICE PRESIDENT. Without objection, the vote will be taken on the amendments en bloc. The question is on the amendments of the Senator from Pennsylvania. [Putting the question.] The amendments are agreed to.

The Bill, with its Amendments, went to Conference, and the statement of the Managers on the part of the House relative to the Amendments in question (Conference Report No. 1882, page 18) reads as follows:

> Amendments Nos. 115, 116, 117, and 118: In the case of an insurance company (other than a life or mutual) under existing law and under the House Bill the gain or loss from the sale or other disposition of property (including securities) is not recognized. The effect of these amendments is to recognize such gains and losses; and the House recedes.

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